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C O N F I D E N T I A L SECTION 01 OF 02 YEREVAN 002510

SIPDIS

STATE FOR EUR/CACEN, EUR/ACE

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TAGS: [PREL](#) [PARM](#) [ECON](#) [EFIN](#) [AM](#)

SUBJECT: THE GOAM'S CREATIVE ACCOUNTING: CREATING AN  
OFF-BUDGET WAR CHEST?

Classified By: DCM A.F. Godfrey for reasons 1.4 (b) and (d).

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SUMMARY  
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1. (C) During the summer and fall of 2004 the GOAM transferred two valuable state assets into the control of the Ministry of Defense or organizations it controls, keeping the revenues and their subsequent expenditure off the books. In June the GOAM transferred 25 aircraft from the defunct Armenian Airlines to the Ministry of Defense, and an August decree allotted revenues from the Zangezour copper mine, Armenia's most profitable state asset, to the "Motherland Military Patriotic Foundation" which is reportedly directed by Armenia's top military brass. The IMF has protested that revenues from the transfer of these assets do not appear on the state budgets and their subsequent expenditures are thus not subject to the review and scrutiny of the National Assembly. Most analysts suspect that the government is keeping these transactions off-budget in order to obscure how much the GOAM spends defending Nagorno-Karabakh. End Summary.

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GOAM IS BANKING OFF-BUDGET REVENUES  
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2. (C) A published government decree from June 2004, approved by the Prime Minister and the President, has established a joint stock company with the assets of the bankrupt Armenian Airlines and assigned 100 percent of the shares to the Ministry of Defense. The Ministry now owns Armenian Airlines' old assets: 25 old Aeroflot planes, mostly old Tupolev passenger aircraft, and it is not clear if any deal will be made with the airline's creditors. The government used a similar decree on August 18, 2004 to distribute revenues from Zangezour Copper Molybdenum Plant, Armenia's single most profitable asset to the "Motherland Military Patriotic Fund." (Note: The Zangezour Copper Molybdenum Plant is one of Armenia's most valuable assets yet to privatized and one of the few state assets to make a profit. The copper mine was offered in a public tender early in 2004 that attracted USD 132 million bids from an American firm and a German firm. The Ministry of Trade has drawn out the sale and made the deal less likely, not least by insisting on selling both bidders 50 percent of the shares rather than awarding the tender to one bidder. In a meeting with the Ambassador, the American entrepreneurs told us that they deposited USD 25 million in escrow to begin negotiations, but now must engage with the German firm to reach a shareholders' agreement, as they have had little contact with their future business partners. The bidders, who currently are also the mine's only client, claim that Zangezour is making more than USD 20 million per year. End Note.)

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MOTHERLAND: A MINISTRY OF DEFENSE SLUSH FUND  
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3. (SBU) A press report quoted the Minister of Trade stating that Motherland is a public institution and that these funds would be used for state purposes. The state register of foundations in the Ministry of Justice had little information about Motherland other than its August 16, 2004 date of registration (two days prior to the governmental decree) and its address, a building owned by the Ministry of Defense. Other usually-public information, notably the foundation's charter and the names of the founders, was absent. Another organization, Martik, is a well-known fund controlled by the Ministry of Defense and is registered at the same address. Martik's board members include Minister of Defense Sargisyan, Deputy Minister Aghabekyan and various Armenian generals. A representative from Martik told us that he knows nothing about the Motherland Military-Patriotic Foundation.

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COMMENT: CORRUPTION OR SOURCE OF OFF-BUDGET FINANCING?  
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4. (C) Both these cases illustrate a systematic policy of making off-budget transfers to the Ministry of Defense and foundations that it controls. In addition to avoiding the

scrutiny of the National Assembly and international observers over military spending, such a mechanism doubtless facilitates opportunities for graft among high-level officials. The government's assignment of Zangezur,s profits suggests that the sale itself, equal to one-fifth of the official state budget, may also be kept off-budget. Indeed, there has been no discussion of how the GOAM intends to spend the USD 132 million in cash it expects to receive from the deal. The IMF has unsuccessfully asked the Minister of Finance to record profits from the copper mine and from the future sale of Armenia Airlines, old aircraft (or, from the operation of the aircraft) as on-budget non-tax revenues. While the government of Armenia is careful to maintain a facade of separation from the "Government of Nagorno-Karabakh," analysts agree that these transactions are being kept off-budget in order to obscure how much Armenia spends on Nagorno-Karabakh's defense.

EVANS